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TAGS: EAGR ECON ECPS EFIN ELAB ENRG ETRD KIPR MX
PGOV, PREL, SCUL
SUBJECT: MEXICO ECONOMIC NOTES, JUNE 2 - JUNE 22

Summary

¶1. (SBU) Reaction to the Calderon Administration's release of its fiscal reform proposal was mixed. Consumer price inflation fell 0.49% in May, resulting in a reduced annual inflation rate of 3.95%. Opening of corn, bean, milk and sugar markets under NAFTA scheduled for January 2008 may not have as negative an effect on farmers as had been previously thought, according to one local analyst. The CROC union (Revolutionary Confederation of Workers and Peasants/ Farmers) may be planning to sever its longstanding ties to the Institutional Revolutionary Party (PRI). The U.S film industry may support PRD Senator Maria Rojo's proposal for a one peso tax on movie tickets to help support Mexican film producers if that would help win her support on passing legislation to stiffen IPR enforcement. Cofetel, the Mexican telecom regulator, published rules on number portability while legislators proposed allowing 100% foreign ownership of firms in the telecom sector. Energy committee chair Labastida called for less government control over Pemex. End summary.

Reaction Mixed to Tax Measures

¶2. (U) Reaction to the Administration's release of its fiscal reform proposal was mixed. The proposal introduces an alternative minimum tax on businesses and individuals, adds a 2% "informal economy" tax on cash bank deposits over about USD 1800 per month, and a 20% tax on gambling winnings. Additionally, to gain support from opposition parties, the proposal allows for the creation of state taxes on products including gasoline and alcohol. Administration experts expect the measures will increase collection from 10% of GDP to 13% by 2012. The state tax provisions as well as the omission of taxes on consumption will help win support from PRI and PRD legislators. Local markets remained

unenthusiastic about the new measures, dropping 1.6% the day after it was announced. Business organizations called the measures insufficient. Finance Secretary Carstens offered a mild defense of the measures calling them "not incomplete." The government hopes the measure will be approved this summer during an extraordinary session of Congress so the measures can be included in the President's 2008 federal budget proposal, which is due to the Chamber of Deputies on September 8. (See Mexico 3246)

May Inflation Fell

¶3. (U) Consumer price inflation fell 0.49% in May, resulting in a reduced annual inflation rate of 3.95%. A Bank of Mexico report said that the prices of electricity, onions, and limes dropped reducing overall consumer prices. Some analysts believe that the decline in the annual inflation rate damped speculation that the central bank will raise interest rates for a second time this year. Yet, there is still concern that inflation will rise due to worldwide rises in interest rates, thereby making emerging market assets like Mexican stocks and bonds less attractive to investors. Core inflation in Mexico for May rose 0.22% to reach an annual rate of 3.73%.

Economist Worried About Competitiveness, Not NAFTA
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¶4. (SBU) At an AmCham briefing on whether the full NAFTA opening of corn, bean, milk and sugar markets scheduled for January 2008 presented a threat or an opportunity to the Mexican countryside, Dr. Ken Shwedel, the Director of

Analysis for the Dutch agro-industrial bank Rabobank, downplayed the potential for negative economic impact on Mexico's farmers. Shwedel pointed out that many of the country's communal producers (generally the poorest of Mexico's farmers, and the ones NAFTA critics predict will be hardest hit by the full liberalization of corn and beans) no longer depend on agriculture for the majority of their income, with those from the smaller communes (less than 5 farmers) reliant on non-agricultural economic activities and remittances for well over half of their income. He also pointed out that most communal farmers grow food for their own (or very local) consumption and are not linked to national, let alone international, markets. At the same time, Mexican agricultural imports and exports have grown steadily, helping keep food prices down and fostering competition for products like avocadoes, tomatoes, and processed foods and beverages.

¶5. (SBU) Nonetheless, Shwedel noted that Mexico's agricultural sector as a whole (i.e., including both the relatively efficient producers tied to domestic and international markets and the relatively backward small and communal producers more engaged in subsistence farming) has grown slower than the rest of the Mexican economy over the past dozen years, foreign investment in the sector has dropped off, and productivity growth has lagged behind that of neighbors like the U.S., Colombia, Costa Rica, and Chile. Even more worrying, despite overall growth in agricultural exports to the U.S., since 2002 Mexico has fallen behind China in terms of produce exports to the U.S. market. Shwedel then asserted that Mexico's corn market is in fact, if not in name, already open, and that U.S. corn crops will be more likely to end up as ethanol than to be exported to Mexico next year. Similarly, he predicted very little economic shock to Mexico's bean and dairy sectors resulting from final NAFTA opening. Shwedel concluded that Mexican farmers have very little to fear in economic terms on January 1, 2008. What they should be concerned about is the failure to use the long phase-in periods provided by NAFTA to raise competitiveness in the sector. A follow-on speaker, Lynch Grattan of a local logistics firm, identified the poor state

of Mexico's road system and the legal challenges of investing in communal areas as just two obstacles to developing a more modern agricultural sector.

Is the CROC Preparing to Split from the PRI?

¶6. (SBU) According to a press report from the northern Mexican State of Coahuila, the CROC labor union (Revolutionary Confederation of Workers and Peasants/Farmers), the third largest national level labor federation in Mexico, has begun to establish municipal political action type committees in various parts of the country. CROC began as one of the various unions linked to Mexico's former ruling party, the PRI (Institutional Revolutionary Party) and the media report speculated that the newly formed committees are part of the CROC's ongoing efforts separate from the PRI and perhaps ultimately form its own political party. A CROC official in Mexico City denied that the union was planning to leave the PRI and told post's Labor Counselor that the committees were a part of the CROC's long standing endeavor to enhance its ability to play an effective role in Mexican politics. The media speculation that the CROC might be leaving the PRI is not outside the realm of possibility given that in Mexico's 2006 presidential election, the union's national leader openly supported the candidate of what is now the country's main opposition party, the PRD (Party of the Democratic Revolution). Since then, the CROC has apparently returned to its PRI roots but speculation generated by the union's brief alliance with the

PRD continues to show up in the press and in various labor circles.

Film Industry Committee Discuss Quotas, Piracy

¶7. (SBU) U.S. and Mexican motion picture business representatives, together with a handful of Mexican officials and legislators, met June 18 for the 17th Meeting of the Bi-national Committee for Promotion of the Film Industry. One of the principal points of discussion was the fact that Mexican-made movies have a hard time finding space on the silver screen and store shelves even in Mexico. A number of Mexican producers and directors attributed this problem to the fact that the major distributors -- all affiliates of the big U.S. studios -- and theater owners -- are unwilling to give local flicks a shot and instead cede the vast majority of screen and shelf space to foreign, and in particular American, movies. They applauded policies in France, Argentina, and Canada that reserve a certain number of screens for domestic films. Representatives of the distributors and theater owners replied that quotas are economically unsustainable, asserted that they have no prejudice against Mexican films, and added that they make decisions based solely on what consumers are willing to pay to see. They pointed out that many Mexican film makers have little idea about the business side of the industry, and offered to put together training seminars to help sensitize them. A number of the major U.S. studio representatives also pointed out that they are co-producing films here in Mexico.

¶8. (SBU) One issue on which nearly everyone in the room agreed was the horrible impact of piracy on the industry. Both Mexican movie makers and a representative of U.S. independent films stressed to econoff that their constituents are hit even harder by piracy than the big Hollywood studios, since in a shrinking legitimate market the available investment tends to flow to sure-fire blockbusters, leaving less to fund smaller, riskier projects. Industry representatives from both countries took advantage of the presence of Mexican legislators at the meeting (including Maria Rojo, the chair of the Senate Culture Commission from the leftist opposition party PRD) to lobby for stronger IPR laws. A U.S. participant told econoff after the meeting that

the American film companies might support (albeit reluctantly) Senator Rojo's proposal for a one peso tax (about a dime) on box office tickets to help support Mexican film producers if that would help win her support on passing legislation to stiffen IPR enforcement.

Number Portability Comes To Mexico

¶9. (U) Cofetel, the Mexican telecom regulator, published rules that will allow both fixed and wireless Mexican telecom users to switch providers while retaining the same phone number. Cofetel has up to 90 days to publish the technical specifications for the project in the Diario Official, followed by a 60 day period in which to hire a company to manage the number portability database. Operators will pass some of the costs of the change to users. Cofetel has also published quality guidelines that telecom operators must follow during the procedure. Cofetel expects the system to be fully operational by the first quarter of 2008. At a recent industry conference, Cofetel President Hector Osuna highlighted the announcement as evidence of the regulator's commitment to increasing telecom competition.

Proposal to Open Telecom Sector to FDI

¶10. (SBU) Legislators from the PRI and "Convergencia" parties sent a proposal to the Economics Committee of the Chamber of Deputies that would allow 100% foreign ownership in Mexico's telecom sector, assuming the investors' country offers the same possibility to Mexican companies. According to an industry expert, foreign investors would likely seek to acquire existing companies rather than deploy their own networks. Using this logic, Axtel would become an attractive candidate for Spanish firm Telefonica, which has been trying to enter the Mexican fixed line market for many years. The National Chamber of the Cable Television Industry (Canitec) and the Federal Competition Commission (CFC) have applauded the proposal indicating that increased competition in the sector would benefit Mexican consumers.

Senate Energy Committee Chair on Reform

¶11. (U) At a June 13 Tec de Monterrey-sponsored seminar on Mexican energy reform, the chair of the Senate Energy Committee, Francisco Labastida told the audience that it was a mistake for the GOM to mandate oil production increases to boost government revenue, rather Pemex and the federal government must build petroleum infrastructure and improve technology. Labastida also called for the creation of an autonomous oil and gas regulator. The Senator is currently developing a first pass at energy reform legislation in cooperation with the Calderon Administration.

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